Ingersoll Rand

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Steve: Thanks, everybody, for joining us for...This is my kickoff of day two here. I had a good day yesterday. Lots of interest. I think the numbers are up pretty substantially from last year in total. It's been good for us in J.P. Morgan. We're very happy that all you guys have joined us.

We're starting today with Ingersoll Rand. CEO Mike Lamach is going to kick it off with prepared remarks.

Michael Lamach: Thanks, Steve. Great to be part of your conference again this year. Thanks for inviting us.

Just to do a really quick overview of the strategy and a few key elements for shareholders to consider. The first thing is our strategy itself is centered around what we believe are very strong secular tailwinds that are driving the world towards greater energy productivity, resource conservation, and environmental sustainability.

We excel at reducing energy intensity in buildings and industrial processes and reducing greenhouse gas emissions. A lot of people don't know that greenhouse gas emissions globally, 15 percent of those are just HVAC systems in buildings. That's before you get to transport, refrigeration, and other areas or business.

It's a significant opportunity there for us, as well as reducing waste and other perishable goods. We excel at generating productivity for our customers. Of course, this has become a very technology heavy business in doing this.

The portfolio creates a great platform for us to be able to grow. We think we'll be above average global economic growth.

The second thing I talk about all the time is our business operating system, which is the way we drive operational execution and excellence into the company. It's how we manage every part of the company in terms of growth, incremental margins, free cash flow.

Over the years, we've built a very experience management team. Part of that high-performing culture that makes our performance sustainable.

When you combine that with the way that we've been thinking about capital allocation over the years in a very dynamic way, we first think about heavy investment organically on growing the business. We've had good success around growing at above market rates. A very strong and growing dividend, at least equal to or greater than the income growth.

Value created M&A and, of course, buybacks through that period of time. That's created a great show of returns. That played itself out in 2018. We think that 2019 will also be a good for us, but in '18 we saw organic bookings of 13 percent, and revenue growth of about 9, and 24 percent adjusted EPS growth per share.

We utilize the operating system all year long to offset and effectively manage all that persistent material inflation that we saw. We actually had positive price to material inflation last year, but there's also freight and wage inflation that was hitting us as well.

2019 we'll see, again, significantly improved leverage, in 2019 implementing that same operating system the same way that we have for years now.

In 2018 we continued that dynamic capital allocation strategy. We invested heavily in the business. We put over $350 million in CapEx, largely related to footprint optimization and some plant consolidations last year. We also deployed about $1.7 billion between dividends, share repurchases, and M&A.

Looking at 2019 we see that fundamentally we'll have good ingredients for another good year for us. End markets generally remain healthy across the globe.

We've entered 2019 with record backlog in a number of business units after achieving exceptional bookings growth in 2018. We believe that we can manage whatever the economy throws at us in terms of inflationary pressure, tariff-related headwinds through pricing and productivity like we've done in the past, using that operating system as the basis for that.

We'll continue to follow the same dynamic capital allocation strategy that we have used for years. Organic business investment, dividends, M&A, and share repurchases will be part of that equation.

Lastly before Q&A, I wanted to spend a minute outlining the acquisition that we made earlier this year. We announced we intended to acquire Precision Flow Systems, which brings scale to our existing fluid management business.

That planned acquisition would combine two great businesses now that provide highly engineered, mission critical solutions with strong brand recognition, deep patent portfolios, and great customer relationships.

PFS is a high-20s EBITDA business. It's EPS accretive in year one, great cash flow, and about 50 percent of the business comes from recurring after-market and replacement sales. It's an asset we've been tracking and interested in for a number of years, and we're excited to bring that on board hopefully about midyear.

With that, Steve, we'll turn it over to you.

Steve: We have 35 minutes left and I have 30 minutes on price cost, so we'll kick that off.

Michael: [laughs] Good.

Steve: No, I just want to get this out of the way. Tariffs, what is locked right now in your price? If some of those back off can you maintain that price and maybe have a little bit of a, albeit temporary, benefit?

Michael: What's been announced and implemented, we've priced for in the marketplace, and then we're poised with anything new that might come along. We've pre-planned what we do in various scenarios around that.

We think that we're 20, 30 basis points probably favorable, if inflation stays flat for us, with the price that we put into the system. Of course, that would be hopeful if we saw any more of a decline in tariffs. If new tariffs were put in place, we're ready to go, but if we don't see tariffs put in place, there'd be really not that exceptional pricing that we saw in 2018.

2018, we had five times the amount of price that we have had in any of the past years that I've been CEO, in one year. That was exceptional.

Steve: If we get a deal or something and they maintain the current tariffs, they don't step up,

you're saying you haven't really put price in place yet to offset those? Therefore, you're not going to get necessarily a benefit on top of the 20 to 30 you're already guiding to?

Michael: Right.

Steve: Is that correct?

Michael: That's right on it. That's correct.

Steve: When it comes to the residential business, there's been some comments at the conference, UTX weak end to the year, positive February. Watsco talking about Florida weakness. Anything on the resi cycle front that you guys are seeing that makes your nervous we're getting towards the end?

Michael: First, just perspective. Recognize residential is less than 10 percent of the revenue of the company. We're largely in the replacement business so that 90 percent of what we do is replacement business. We've seen no softness this early in the year and no reason to change anything that we've been communicating in terms of the guidance that we've laid out.

Steve: Pricing remains pretty firm?

Michael: It does.

Steve: The pricing discipline there remains firm?

Michael: It does.

Steve: On the commercial front, orders can be lumpy here. Are the pipelines and quotation activities around commercial equipment maybe go globally? Is that enough to have another good year of orders growth in 2019, or do we have a little bit of a pause as we digest the backlog?

Michael: We've got great visibility into the institutional stuff that's happening across the world. It's actually a pretty strong environment, globally, for different reasons. If you go to the EU and China where you've got a clear focus and mandate around clean air, clean water, you've got compliance and regulations driving improved reduction of greenhouse gas emissions and efficiencies there driving great growth for us.

We've been compounding 20 percent plus now there, both in China and Europe, for the past four or so years. We'll double the business by 2020 from 2016 levels. It's not based on what's being built. It's based on how new refrigerants and new systems are really impacting this whole environmental imperative.

If you come over to the US, you've seen a very strong institutional environment and a slower, steadier institutional recovery than what we've seen in the past. Part of this is paced by the amount of labor available to really build a lot of what we're seeing out there.

The availability of electricians, pipefitters, welders, carpenters is not what it used to be. It's a longer, flatter institutional recovery. I think we're still relatively early innings there.

On the commercial and industrial HVAC parts of the business, industrial, surprisingly, very optimistic. I came back from the National Association of Manufacturers Conference yesterday. For the seventh quarter in a row, over 90 percent of the manufacturers in the US are very optimistic around the potential of what they see in 2019. We're seeing that in our process cooling business.

Commercial, for us, is widespread. People think about office buildings, but for us, it's data centers. It's vertical agriculture and farming. There's lots of growing areas of the business, and we haven't seen the weakness yet in commercial office buildings. It's been a universally strong environment.

Even in Latin America, we've seen some recovery in Brazil. It's a little choppy in places like Mexico. We're generally optimistic in South America as well. We really don't see too many clouds on the horizon from the commercial HVAC front.

Steve: What specifically are you seeing in China? Obviously, a lot of cross-currents there. How are you approaching that in commercial HVAC?

Michael: Codes and regulations, for us, the big investment we made into the sales force there, the direct sales force. The ability to specify and design systems into buildings and have that be the basis of design has been really a positive for us.

Then you're playing into now an environment where it's a long-term view toward efficiencies in the environments. You're finding customers that are receptive to and have a goal around greenhouse gas emission reduction. A lot of the people that we're selling to in China, specifically are golden

rewarded for having an environmental conscience around that.

Five years ago, had we been the high bidder and been awarded projects some of those same customers might have been worried about being accused of bribery and corruption. Now they're being rewarded for doing the right thing for the environment and for long-term decisions around energy efficiency.

10 percent of the total cost of a project over 30 years is the equipment. The other 90 percent of it's the energy used, the maintenance, and the refrigerants. If you have an advantage on the efficiencies, the maintenance intervals, and on the refrigerants used it's an enormous advantage to win in that total cost of ownership equation. That's paying out nicely in China.

Steve: When we look at something like floor space starts or whatever, it's not a very accurate metric given you guys do a lot of commercial over there. When we think about general property markets should we watch infrastructure trends or does it not really matter? You guys can grow through the macro as long as it's not too negative?

Michael: At best watching square footage in place, Dodge McGraw-Hill data, or some of the data that you can pick up in Europe or China is probably picking up 50 percent of what we see. A lot of this is demand creation that we have going in and retrofitting old equipments and having that sold on a payback.

I'd say it's even less so today reliable to look at the square footage data because there's environmental tailwinds in the EU and in China in particular. That those two parts of the world that are pushing toward compliance and regulatory improvement there, that's driving another leg up.

Our 20 percent compound growth in these places isn't because we're putting in place 20 percent more square footage. It's because we're putting in really efficient, really environmental friendly systems into these buildings, and that's being rewarded.

Steve: In 2018 how fast did China HVAC grow, and then what do you expect it to grow in 2019?

Michael: Again, from '16 through '20 we'll have doubled the business. There's been some choppiness in that, but we'll grow above the market in China. We think the market in China probably it's a low - to mid-single digit at best market in China. We'll outgrow the market in China.

Steve: In Europe been somewhat interesting. Some guys have had terrible results. You guys

have seemed to have pretty good results. Maybe the Middle East swings that around quite a bit. People call it ME instead of just Europe. Talk about what's going on in commercial HVAC in Europe.

Michael: In Europe, again, this is the most environmentally conscience place in the planet. Here, this is where we're totally separating from the pack in terms of what's being built.

We're seeing awards that we're having by virtue of the fact that 99.9 percent of the greenhouse gas emissions are being reduced with the new EcoWise portfolio we've put out into the marketplaces. That's been strong.

In the Middle East it's interesting, again, too, because here you've got this district cooling environment where cooling is sold as a utility. Cooling is sold like we would buy power or water here.

Cooling is sold as a utility there, so it favors where you've got these large chiller plants and these very, very efficient systems where they're thinking about these 30-year asset lives. We may have a 2, 5, or 10 percent total life cycle advantage, and we're able to parlay that into higher share. We're seeing large rewards there.

It won't mean a lot to people, but this is often sold by tons of cooling. We'll see in the Middle East projects with hundreds of thousands of tons of cooling sold at a time in a district cooling plant, which is exactly in our sweet spot.

Steve: When it comes to competition in pricing the competitors, JCI, York, Carrier, they're not standing still. You go to the AHR show and York's booth is now the size of Atlanta.

What is the pricing environment like? Are you seeing these guys be a little more aggressive to get their new products installed because they're a little bit behind you guys from the R&D flywheel perspective?

Michael: The key of it has always been to continue to innovate. If you leapfrog and you stand still it's not going to be very long. We're out of the second and third generations of what we're doing within the compressors themselves, with the control systems, and with the efficiencies.

We've got roadmap in front of us around how to make systems more efficient, have lower maintenance cycles, and even give refrigerant optionality into the future. Those refrigerants

change it's a very modular approach that we would have to be able to adapt to these new refrigerants going forward.

That's been a constant drumbeat around investment back into the business. You'll see us like clockwork putting about 50 basis points of margin into each quarter, into each year around some on the development.

We've spent somewhere in the last, I'd say, four or five years, on average, between $330 million and $500 million a year just in the engineering, product management, and the compliance side of what we're doing to drive these efficiencies and these new refrigerants through systems. That's been our focus and our effort to stay ahead of the competitors.

The pricing has been good because, again, if 10 percent of it is based on the price of the equipment today and 90 percent of it is based on the relative differences in efficiencies, if you're talking to somebody that understands that, and most customers do understand that, there's an opportunity to sell a value there.

Steve: Your realized price in commercial equipment last year was one to two percent, something like that?

Michael: I don't know if I could look at it that way.

Steve: We think about the services business. You've been growing it really nicely. What's been the trick to the trade there?

When you think about your forecast for low- to mid-single digit growth for commercial HVAC for 2019, I would think services is still outpunching its weight, but equipment also sounds pretty good. What's below and above that number when you think about services and equipment?

Michael: For about a decade we've been growing the services business both in air compressors and in commercial HVAC something north of eight percent compound growth rate. That's been a focus on developing the offerings to sell in a service.

A lot of what we're doing now through digital services and through some risk sharing arrangements with customers in our rental fleets we're able to offer a suite of options for customers that want to buy service, essentially transfer risk.

Because we've got great intelligence now in automation coming back on these systems we're able to stay in front of that on a moment by moment, daily basis as to how equipment's performing and backstop that with both services from our own field people or from a rental fleet if that is what the customer wants.

We've dedicated huge parts of the organization to working on the service developments, the service offerings the same way we would look at a product offering of actual equipment itself. The key has been applying the same innovation to the product offering of service as we have toward the product offering of equipment and linking the two together.

It's almost now that if somebody buys a complex system from us, particularly a big institutional customer, they're going to buy service as part of that equation, even in China.

Steve: How big is your service business now within commercial HVAC?

Michael: It's half.

Steve: When you look at that low- to mid-single-digit growth rate, what's growing above and what's growing below? Services, to me, doesn't sound like a low-single-digit grower. What's growing at low single digits?

Michael: You've got some currency going against you in places, obviously. Currency's a drag on that. You're looking at mid-single-digit organic growth rates in the HVAC space for us, that four and a half, five and a half percent range. You'll see services growing a bit above that. We'll see institutional growing at about that, and you might see some of the commercial growing a little bit less than that.

Although we haven't seen it yet, at some point in time you think, "Gosh, the commercial market, particularly in the US, might be out of gas." We're not seeing that yet, but there's somewhat of an estimation that that is likely to happen and to look around that corner and find it.

It's also why we've taken some of the restructuring that we've taken to really get the footprint into an even better position coming into what might be a rougher patch at some point on the commercial side of the equation.

Again, if you pull back the HVAC business, and you say 50 percent of it's service and 50 percent of it's equipment, even the equipment side is going to be split between institutional and then

commercial and industrial, about half and half, so a quarter, a quarter.

Then you take the commercial-industrial, and data centers are growing and showing no signs of slowing down. Vertical farming is something that's picking up. We're seeing great application and content for what we do. It's a long way before you get to the smaller, commercial office-building environment, before we would get worried.

Steve: It sounds like mid-single-digits is pretty conservative?

Michael: I know you think so, so keep it.

Steve: I'll go to the high end of the range. On the difference between applied and unitary, any dynamics around mix that are going to change, so that if you do get better growth, you're not going to convert as well?

Michael: Love both. The applied, generally the sale itself could be at a slightly lower margin, but you're picking up this big service annuity. The service annuity is probably worth eight to ten times the margin of the equipment sale over the 30 years that you have that project. We love both, but certainly, the service business is kicking pretty quick on the institutional, applied side.

Steve: Just to back up to China to round out the conversation, you guys added a bunch of resources there, whenever that was. I lost track of time a little bit, but I think it was a year ago. Was '18 the year where you started to see favorable comps on that, leveraging that investment, or is that still one to come?

Michael: We saw it almost immediately, which was a shock. We planned a little bit more of a lag in there. Thinking about that retrospectively, for 100 years, we hire generally people right out of college with engineering degrees, and we send them immediately to a six-month program.

We run two six-month programs a year and really teach people the HVAC systems business. Before they learn the equipment and the controls business, they really understand that. We were able to really accelerate that, continue that for the people we brought into China.

They generally then apprentice under a more senior sales engineer for a period of time, but the productivity there was very, very quick in that regard. '19 should be a very good year for us in terms of that...

Steve: Was a lot of reflected '18, or is that something that's coming on in '19?

Michael: Some of that. You're mixing between the additional costs in '18 and then people becoming productive. The productivity curve is as fast as we've ever seen it. In all the time, all the places we track, the productivity of new sales engineers coming into the company, I've never seen it faster in China with what we've done with those...

Steve: That growth there should be pretty accretive over time?

Michael: I think so. Yes.

Steve: One last question on services. What's the different rate of penetration, regionally, as you think about attachment rates?

Michael: The lowest is still going to be Asia, specifically China, but the attachment rate here on new sales is north now of 50 percent. Let's say it would have been maybe 20 percent five years ago. You're seeing a very high attachment rate.

If you come over the US or Europe, it's 80, 90 percent attachment rates, initially. We call it linkage. You sell the equipment. You sell the service. Eventually, we're going to do service just about on everything we do, but that immediate linkage now is a very high rate, 50 percent plus in China, 80, 90 percent in the rest of the world.

Steve: China has some room to run?

Michael: I use the analogy it's like a car. You're just not going to pop the hood on a new Mercedes and figure out what's going on with the engine. It's software, it's controls, it's hardware, and you have to have a systems view.

The people that work on this are striped collar. They're blue and white collar. They're technicians. They're mechanics. You're not going to take your Mercedes to the BMW dealer. You're generally going to get the diagnostics and the work done with the people that know what they're doing.

Steve: The length of those normal contracts is a couple years? Is there a normal attrition rate?

Michael: The attrition rate's interesting because we look at that as an attrition rate on number of

contracts and then attrition rate of dollars. The attrition rate on contracts is small. It's in the single digits. The dollars actually go higher than 100 percent, which is a great sign.

Which means that, generally, if we're doing service in a building, we're going to do more service the next year by taking on more services for the customer. Services, just about any way you slice it, is the gift that keeps on giving.

Steve: That margin is inherently higher than the equipment?

Michael: It is. It's probably a good 10 to 12 points higher gross margin. The cost of service, it might be five to seven points. You've got different training, different tools and vehicles, and downtime, windshield time, but you still net out about five to seven points contribution on that.

Steve: Can that be a 20 percent margin kind of revenue stream someday?

Michael: I think today it probably is pretty close to that.

Steve: Wow. Any questions on commercial HVAC out there before we move to Thermo King?

Steve: Thermo King, lots of different revenue irons in the fire versus last cycle. Maybe talk about what's different and your favorite initiative on the APU side, as to why we shouldn't worry about Thermo King in the context of bad truck orders in the US.

Michael: I always use the word resilient with Thermo King because people generally think about Thermo King as being a North American trailer business. You have to realize that it's a North American trailer business. It's an international trailer business. There is a truck class three to seven straight-body business.

Importantly, there is an auxiliary power unit business, and we've got a one-year full backlog on that. The information that we put forward on the last investor day, we had a number of initiatives we were showing. I think we had APUs at $100 million of incremental. We're well past that already in 2018. That's gone wonderfully.

We've got a rail, a bus, an air cargo business where you're refrigerating pharmaceuticals and active ingredients -- that's been a big business -- and a telematics business, which cuts across all of that, as well as a parts and service business, which is about 20, 25 percent of the portfolio. It's a much more diverse business.

Everyone worried in '16 when the truck build, trailer build went down what would happen. We actually grew Thermo King, and we grew the margins. We're less worried about Thermo King because folks look at the growth rates in Class A, tractors or in trailers, which are very, very choppy.

We're seeing a much smoother order in growth rate as it relates to actually putting auxiliary power units on or putting refrigerated units on trailers. We're only selling those when the trailer's available, when the tractor's available, so we don't get that lumpy, choppy view.

It'll continue to be a good business for us. As it relates to more and more locally grown product and more and more last-mile delivery, we're also adapting our businesses to be able to accommodate that, again, class three through seven truck or alternative means of moving refrigerated perishables.

There's also this movement toward electrification of the entire portfolio. Think about how cars and trucks are being electrified. The same thing is happening with the refrigeration cycles that power this. There's a built-in regulatory opportunity and a built-in opportunity for us to innovate in the electrical side of that whole cycle.

Steve: If this business, profit-wise, went down -- I'm assuming it went down a lot in '08-'09 -- you have a recession half as bad, what do you think is the right kind of profit construct for TK?

Michael: I think for the company and for TK, and we've pressure-tested a lot of this, we stay within that 30 percent de-lever. If you had a 10 percent decline in that company, across the board, I think we stay within that 30 percent range.

Steve: Any questions on Thermo King, refrigerated trailers? On industrial, what are you guys seeing, broadly, there? Maybe talk about the services initiative in industrial as well, whatever you're seeing in China, too.

Michael: Equal to the HVAC commercial story, there's been high-single-digit compound growth rates in service there. Same playbook, taking these professionalized offerings and service like you would have for the product itself, whether they're risk-shifting arrangements with customers or it's automation being applied to how we're providing those services, that's the same playbook there.

The channel, part of the channel being separated and focused on services and share a wallet by customer, the same linkage kinds of rates that we're seeing. Every time the economy goes through a cycle, you find, in the industrial space, fewer and fewer customers that want to self-perform that work.

A lot of the industrial customers held on to self-performing that work for a longer period of time. As we're repeatedly gone through cycles over the last, say, 25 years, fewer and fewer people coming back in. We're seeing more of that now being outsourced to people like us for industrial application.

Here again, 50 percent service penetration, 50-50 service versus completes in the compression technology business. Really great success across the oil-free platform. I think now we're number one oil-free in China. It tells you that when you've got the product, when you've got the footprint and the channel capability, and you're starting from an even starting line, we're able to win.

I think we're a strong number two in that space in North America. We're a distant second in Europe. There's opportunity, depending on how you look at it, certainly in Europe and North America, to close that gap.

Steve: Again, a low- to mid-single-digit guide here, but if services is growing, do you expect services to grow high-singles over time?

Michael: Currency hits us a bit harder here just by virtue of how that footprint works. On an organic basis, you're probably half a point to a point lower growth rate, organically, than you are on the climate businesses for us. That translates into just a touch lower recognized revenue as it relates to some of the currency. I think it's a low-single-digit reported number this year.

Steve: What's the biggest concern there? What's the business that you're watching the most from a risk perspective?

Michael: Manufacturers are generally optimistic. [laughs] They feel like once they know the rules of engagement, they're going to know how to play that. There is this sense of sitting on capital before you deploy it, not knowing how you might want to arrange your footprint.

In a lot of ways as it relates to larger compressors, and think about customers making larger compressors going into larger processes and larger capital investments, more hesitant to go deploy that capital without knowing the rules of engagement around tariffs or around trade.

I think any certainty around that would be a positive for all industrial businesses and certainly for our compressor technologies.

Steve: What are you seeing in China on the large compressor front? I know that was an area you'd highlighted last year.

Michael: That's where you see Chinese customers that had an export plan to the US doing a couple things. One, they're figuring out how to sell that capacity to other parts of the world and establishing new trade partners around that.

You also see some movement of actually putting a footprint in Vietnam or moving some of their operations to other parts of the world, which will benefit us again, as our footprint is strong, generally, around the world. We're able to participate there just the same as China. There's a delay in that. There's a little bit of a lag time as they figure that out.

Steve: Are you seeing any air pockets here early on in the year?

Michael: We saw the air pocket, I think. We saw the air pocket last year, and I think nothing's really changed there. It's not a bad environment. It just could be better. You think about what happened with US tax reform. If we could just get that plus this tariff thing put to bed, I think you'll see another leg up in the industrial economy.

Steve: One last one on the businesses. What is the guide for Thermo King this year, organic growth?

Michael: I think for the segment we said four and a half to five and a half, and we haven't gone into more detail around...

Steve: TK around the average?

Michael: TK is around the average. It's not that spiky 70 percent number you see with trailers or trucks because we just don't book that way and ship that way. We ship just in time when they need it. Not a lot of difference there.

Steve: Anything on the macro or the businesses before we go...

Michael: On that question, if you look at North America ACT, it might be like a 48,000-unit build versus a 46,500-unit build. It's a one, two percent industry growth rate around that.

Steve: Management doesn't let us pay for that data, so I haven't seen it.

[laughter]

Steve: Seriously. Any other questions on the businesses, the macro, or anything like that?

[pause]

Steve: Moving on to the balance sheet, first of all, free cash flow. A little bit of a light year in...I'm not blaming you. I'm just asking you because you're the numbers gal. In 2018, is there any catch-up that we should expect in 2019?

You said around 100 percent, but sometimes these things can swing in various ways, year in, year out. Anything that reverses, that makes it maybe it a little bit of potential for an upside from that 100 percent conversion in '19?

Susan Carter: I think that the guide of $1.6 billion is slightly over net income for 2019. When you look back and you look at 2018, we had a little bit higher working capital than normal. However, we had a lot higher growth than what we would have projected for 2018. We also had higher CapEx, good projects, good investments.

What I would expect to see happen to transition 2018 to 2019 is working capital's going to come back down into the three to four percent range. That's not going to occur in Q1, just to get everybody baselined. This is going to go throughout the year and really get through the bigger quarters, second and third quarter.

In CapEx, we've guided down from the $366 million last year down to the $300 range. You're going to get some more cash flow, but we're really confident all our businesses have a very, very detailed metric around free cash flow. Our long-term incentive plans also have a cash flow ROIC component.

We're very serious about cash flow. We are a good cash flow-generating business, and we'll get over 100 percent of net income over time.

Michael: For those that don't know the company that well, for the last four or five years, we've averaged over 100 percent conversion...

Susan: We have.

Michael: including the 2018 weaker number. It's something that we really take a lot of pride knowing how to do this, and we'll get it done.

Fundamentally, we had twice the growth rate in '18 versus what we had planned. Between that, the tariffs, and some of the supply constraints, we wanted to make sure that we had enough components to build whatever our customers wanted.

There was a reason for the higher working capital in '18, but I think that in '19, you're going to see us come back to that 100, 100-plus number.

Steve: I think the CapEx thing was interesting, too, because you guys are doing some work around footprint. Is that $300 million a floor, or can you continue to work your way down on the CapEx front as you chip away at your footprint? What is the percentage of sales that's normal for you guys do you think?

Susan: It's an interesting question, Steve. Before 2018, I would have said that not all the CapEx that we put in the guide actually gets realized. You go through the year, you do business cases, some things fall out, some things aren't the way you planned them. In 2018, everything was as we planned it.

I wouldn't really count on that $300 million of guide going down. However, I will say that as we go throughout the year, we are doing a business case and a value creation for every piece of the CapEx. If something doesn't meet the threshold or something has changed in the environment, then it would change that number.

Like I say, that's not what we saw in 2018. We saw good projects. We saw good returns. I expect that we'll be right around that $300-million level in 2019.

Michael: Our restructuring in '18 and '19 was higher than it was because we were getting at the larger footprint changes that are out there. If you go back over a long period of time, like a decade, we're probably down to half the footprint that we had in terms of physical factories. We're running out of spaces. We're down to 40, 43 factories across the whole organization.

These were two of the larger moves that we've made. We don't really have anything teed up in 2020 that's going to be of that magnitude relative to the restructuring portion of the CapEx. It would really be around innovation, and NPD would be the driver on that.

Steve: I would think that the benefits of that footprint, yes, it's kind of reflected in your margin today, but it makes you a better, more resilient company in a downturn.

Steve: You can take this new car for a spin when things get pretty tough.

Michael: That's exactly right.

Susan: Those actions do have a three- to four-year payback.

Steve: A little longer payback.

Susan: Yeah.

Steve: You have yet to see the real fruits of that labor?

Susan: Correct. We're starting to see the 2017 and then 2018 layers on, but it doesn't all occur at once.

Steve: HVAC consolidation, I'm not going to let you off the hook without asking you about that. The Carrier guys say tax and regulatory hurdles. The Lennox guys say there are no hurdles to anything. Sir, what do you say?

[laughter]

Michael: We can identify about 15 companies that are in that space. I think the top 4 have one set of issues around consolidating, but 5 through 15, it's a whole different set of issues and topics. I do think that if we spend $300 million to $500 million a year staying in the game, being relevant with innovation, technology, regulations, it's got to be hard on players 5 through 15, in the long run, to stay there as well.

I think you could see consolidation in players one through four. I think they would have to be cooperative endeavors because there's nobody going to take on the risk of that independent of

the other party agreeing to help in that overall equation.

I do think it could happen, and different combinations have more to do as it relates to what would need to be divested. I think it'll happen over time. I think, particularly 5 through 15, it'll happen over time.

Steve: As far as the deal you guys just announced, are there more of those in the pipeline or, "Hey, we just did a billion, four. We're gonna digest a little bit."? That's reasonably large for what you guys have done in the past. How do we think about the M&A pipeline?

Michael: On the fluid management side, that's a big transaction. There's nothing of that kind of scale even out there at this point. You go from there to it's the size of an IDEX or a Graco or something around those lines. Those are in that space. These are all really small, niche-application bolt-ons from that point.

They make a lot more sense now as you get the scale between the full fluid management business, but as it relates to other pipeline activities we've got, they remain really in the compressor technology space, in the climate segment, particularly in the HVAC space, both technology and channel. Thirdly, you see it in fluid management. They get really small in fluid management from here.

Steve: Any questions on the balance sheet, M&A, or anything like that? One last one, the algorithm on productivity. How should we think about that, year in, year out? Does that accelerate because you're at the tail end of your restructuring now, or you're going to spend most of whatever upside you get? Does that go into investment to manage the number?

Michael: Always, when we think about this, generally speaking, we think about price over material inflation. 20-30 basis points is what we target. We think about all other productivity covering all other inflation. All other inflation would be indirect, it would be labor, etc.

Then we think about volume dropping through. It's something around 25 percent volume in mix, and that's how we get to the 25-ish number that we have in '19 for leverage. What I'd say in '19 is no exception. 20 to 30 basis points is what we're trying to do, price over cost, material cost.

We see productivity slightly outpacing all other inflation, and we see a pretty good volume environment. No reason to think we won't see 25 percent dropping through on the volumes. That's how we get to the midpoint of '19.

Steve: One last quick one, corporate costs. You guys are among the highest in the sector as a percentage of sales. Is there opportunity to work that down, or is there stuff in there that is more operating in nature...

Michael: We started about 18 months ago, and for two years, we've essentially held that flat against a dramatically...an increase in revenue. Through that, we've actually come now, on a G&A basis, to the middle of the pack. I think there's a lot more we could do to get to top quartile, and we've got a second year in 2019 to get at that.

If you remember, it was like a $100-million number sitting out there about two years that we thought we could get. We got about half of that last year. It got absorbed on a percentage basis into the higher revenue number, but I think we've got an equivalent chunk that we can take in '19 and beyond.

Susan: The other thing that I would tell you about that, Steve, is when you think about corporate costs and you're trying to compare them across groups, everybody does corporate a little differently. What I would look at is G&A. What is G&A as a percentage of revenue, and how is that changing, over time?

Steve: What is your G&A?

Susan: Our G&A is roughly eight percent of revenue, nine percent of revenue. I didn't include S, right? I included G&A. If you look at that across businesses, we're more comparable.

Michael: The higher the service business, the higher the G&A as well. We actually bias up as we grow the service business with a higher G&A.

Steve: Are our guys too much probably, too? That's my...

Michael: They're good, though.

Steve: They are very good. Thanks a lot. So are you. Thank you. Appreciate it.

Michael: Thank you.